Microfinance Business Models:
Comparing and Contrasting Grameen Bank and Compartamos Banco

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ABSTRACT

This thesis compares two microfinance business models, the non-profit Grameen Bank model and the commercial for-profit Compartamos Banco so as to identify industry best practices. Although there are many differences between these two models, the author concludes that the fundamental distinction between them is in their funding methods. Grameen Bank funds microloans primarily through local funds usually from savings deposits, while Compartamos Banco takes a funding approach that is similar to that of traditional commercial banks, including engaging in an IPO to fundraise. Based upon an analysis of respective business models, both institutions, in aiming to reduce poverty, believe that reaching scale and financial sustainability is important. Qualitative analysis and secondary research are used to gather the data that provides this analysis.

The author concludes that in order for Grameen Bank to effectively reach its objectives, it should manage savings deposits to generate more microcredit rather than the large amount of interbank lending that is being generated as fixed deposit investments. Compartamos Banco’s commercial model is effective in reaching aggressive financial growth. However, as it endeavors to scale for higher social impact, without industry-wide support (which identifies borrower’s overall indebtedness), pure expansion could lead to disastrous consequences (Andhra Pradesh crisis). Risk can be better managed by smaller scale peer pressure in case there is no system to identify over-indebtedness. The analysis also highlights how microfinance institutions find it difficult to balance social impact and financial returns.

Thesis Supervisor: Charles F. Kane
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1. Introduction

1.1 Purpose of Thesis

My purpose of researching and writing this thesis is to gain an understanding of microfinance and examine the best practices of microfinance business models. In order to gain a deeper understanding I will be comparing Grameen Bank and Compartamos Banco, both of which are very successful microfinance institutions founded in Bangladesh and Mexico respectively. The rational behind these two choices is that although they both serve to provide microloans for the poor, Grameen Bank is a nonprofit organization whereas Compartamos Banco is a for profit institution which leads to different approaches and decision making in managing microfinance. The method of funding, their uses of profit, interest rates charged on the loans and many other management decisions all differ due to the different approaches in reaching the same social goal – providing financial services to the poor to reduce poverty. In this thesis, I will perform a comparative analysis of the two institutions to find the best practices of microfinance.

1.2 Microfinance

1.2.1 Definition

Although the definition could differ slightly by different groups or regions, microfinance encompasses financial services that are provided to micro-entrepreneurs, micro-businesses and individuals at the bottom of the economic pyramid who lack financial services offered by traditional banks. In many cases, the term ‘microcredit’ (also called microloan) and
‘microfinance’ is not carefully distinguished for accurate usage so ‘microfinance’ is commonly used to refer to ‘microcredit.’

1.2.2 Milestone

Microfinance has been practiced for the last four decades. Many institutions were born as nonprofit organizations in the early history of microfinance but some have evolved into commercial organizations, following the traditional financial system’s approach to provide credit. The “modern microfinance” loans and experimentations started in the 1970s by several institutions in Asia and Latin America simultaneously but separately (Chu & Cuellar, Banco Compartamos Banco: Life after the IPO, 2008). In Asia, Bank Dagang Bali from Indonesia started microfinance in 1970, followed by Grameen Bank Projects from Bangladesh in 1976 (Chu, BBOP, 2013). Grameen Bank Project turned into an establishment of Grameen Bank in 1983, and the founder Muhammad Yunus later won the Nobel Peace Prize for his microcredit development movements to eradicate poverty. In the meantime in Latin America, Opportunity International was founded in Colombia in 1971, and ACCION International of Brazil came in 1973. During 1980s and 1990s, the leading nonprofit organizations such as Grameen Bank and ACCION financially broke even. It was between the 1990s and 2000 when some major microfinance institutions (MFI) such as BancoSol of Bolivia, Mibanco of Peru, and Compartamos Banco of Mexico started tapping into capital markets for funding and became regulated MFIs. In the recent decade, some MFIs such as Compartamos Banco and SKS of India

Modern microfinance has been able to deliver banking for the poor for the first time in

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banking history. Traditionally, people in the bottom of the pyramid had no access to formal banking. Traditional banks did not provide services to the poor because the revenues on managing accounts with small or low balance did not cover the costs. Also similarly, fixed costs on issuing small loans versus larger loans provided less incentive for banks to provide microloans, and their assessment on loans to the poor had high risk as it was assumed that default would be high since the poor generally had insufficient collaterals or other income to repay the loans. For the poor, the only way to access loans was to borrow from private moneylenders. According to Michael Chu, Senior Lecturer in the Initiative on Social Enterprise of the General Management Group of the Harvard Business School, “rates in this “informal” financial system could range from 5% a week to 30% a month, and even 100% a month, which translated into annual rates of 1,100% to 2,200% or more. Poor people could pay those rates because loans were extremely short in duration, interest rates were only part of the total cost when considering financing alternatives and the productivity of loans was extremely high where capital was so scarce” (Chu & Cuellar, Banco Compartamos Banco: Life after the IPO, 2008). So when the pioneers of MFIs introduced microloans without any collateral, and still maintain high repayment rates with positive profits, it was an innovation. Microlending became a breakthrough for the bottom of the pyramid who were trapped in the clogged financial system, or market inefficiency. These astonishing results contradicted many preconceptions and fueled the growth in the microfinance industry up to today.

1.2.3 Crisis in Microcredit

Microcredit has brought flow of the money into the poor and helped reduce poverty. However, some criticize microcredit for over-indebting and charging high interest payments on the poor. We have seen a microcredit crisis from Andhra Pradesh of India, a state where MFI
debt related suicides occurred, ultimately leading to government intervention to stop collections for loan repayment. Allegations made against MFIs were charging high interest rates, encouraging multiple loans, ‘forcefully and unethically’ collecting loan payments, and poaching SHG (government supported loan) borrowers (Rangan & Lee, 2010). MFIs responded that no direct suicides were linked to MFIs but some large MFIs ultimately agreed to cap interest rates at 24% to respond to the crisis (Chu, BBOP, 2013). I believe the crisis arose from a systematic level. The combination of different weight of decisions made from many stakeholders (MFIs, private moneylenders, state government, federal government, politicians, the World Bank, and individual borrowers) of microfinance in Andhra Pradesh comprehensively led to the crisis. What originated under goodwill – helping the poor - turned into a social crisis. Therefore it is important that MFIs not only effectively manage their operations but also manage the social consequences to prevent reoccurrence of such crisis.

1.3. Why compare Grameen Bank and Compartamos Banco?

Many MFIs have different views of where they should position themselves on the scale of nonprofit to for profit business models. Their daily management decisions differ to various extremes depending on their models. Grameen Bank and Compartamos Banco are two major MFIs that stand on these two extreme positions. Although they both provide microloans with a same intention - to reduce poverty, Grameen Bank established itself as a nonprofit organization. On the other hand, Compartamos Banco converted from a nonprofit to a publicly listed commercial institution on Mexican Stock Exchange, taking the same form of typical companies in the mainstream of the financial industry. Grameen Bank pursues a social model while Compartamos Banco pursues a commercial model.
Financial return and social impact is often perceived to have an inverse relationship; increase in the value of financial return results in a decrease in the value of the social impact and vice versa. For those reasons, naturally it was the nonprofit organizations, local government, or international agencies that took the lead in creating positive social impact - especially when it came to reducing poverty – even if it came at a cost to the organizations or the nations. MFIs, aiming for different impacts formed as nonprofits, commercial, or in many other forms between the scales of nonprofit to commercial organizations, and as the industry grew and it was making more money from the poor, more debates emerged on whether making profit through charging high interest payments on the poor was acceptable. Many points for the debate is to what degree it should be acceptable to make money from the poor. While there are some businesses in other industries that make high financial returns and high social impact at the same time microfinance businesses have yet to find the perfect balance between the two. MFIs are still between deciding whether to aim primarily for reducing poverty with a minimum financial hurdle, or aim for high financial return with a minimum poverty reducing hurdle. Grameen Bank pursues the former while Compartamos Banco is somewhere between the two extremes pursuing both commercial return and poverty reduction.
2. Key Differences between Two Banks

From my observation of two banks, I have divided their core differences into the four following criteria. Their core differences originate from the disagreement in the philosophies of how one should manage an MFI. The following arguments and information for each bank are based on debates of Muhammad Yunus, the founder of Grameen Bank and Michael Chu, the visionary behind Compartamos Banco at the World Microfinance Forum Geneva, on October 1-2, 2008 (World Microfinance Forum Geneva, 2008).

2.1 Nonprofit versus Commercial

What each bank believes in as a role of MFI overlaps completely when it comes to helping poor people overcome poverty. The business models that they believe in to achieve this goal, are different. Compartamos Banco believes that only a commercial microfinance business model could achieve this while Grameen Bank believes the profit should not be taken from the poor in order for the poor to really escape poverty.

Compartamos Banco

Compartamos Banco pursues a commercial MFI model. For making money from the poor, Chu says “To me the only valid perspective is not how we feel about earning a profit from the poor, but rather what is valid in the eyes of the poor.”

He suggests that four things need to be accomplished simultaneously and consistently to “truly roll back poverty, not just alleviate its symptoms.”

1. Reaching a huge number of people in poverty;
2. Permanence that will continue beyond one generation and not just reach to the today’s generation;

3. Efficacy that continues to get better and better throughout time; and

4. Efficiency that continues to get the business cost less through time.

He says that business is the only thing he knows that can provide these four, and an industry, which he says can form when above average returns of economic activity is present, needs to be created to achieve them. “Commercial microfinance matters in the eyes of the poor because it means there is an industry; strong and mighty; because it is healthily profitable, standing behind their financial needs... the only way to mobilize the money needed to meet the credit needs of the poor is to connect to the ocean of commercial money.” Assuming about USD 500 billion is needed to reach just half of the people who might need microcredit over the world, he thinks it is legitimate of MFIs to claim commercial funds.

Compartamos Banco does not believe in the inverse relationship of social impact and good profit. They say that small loans do not make money for MFIs but when MFI makes right credit approvals – that is if they lend to the poor who does not end up in debt but generate income out of the loans - the clients will prosper from the initial loans and gradually qualify for bigger loans. This eventually leads to helping the poor as well as making a good profit, a win-win for both clients and MFIs.

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3 Assumption: It does not take stretching the definition of poverty too much; to think that 4 billion people of the 6.5 billion in the world live in unsatisfactory conditions. If you assume an average family of four, that means 1 billion families. If you assume that half of them would benefit from microcredit (because not everyone benefits from financial services) that leaves 500 million families. If you assume an average loan of 500 USD, that is 250 billion USD. And if you assume some growth in loan size over time to 1000 USD, you are talking about 500 billion USD. (World Microfinance Forum Geneva, 2008)
Grameen Bank

"Grameen Bank is a profit-maximizing institution. We are not ashamed to make money. On the contrary, we expect applause when we manage to give a 100% dividend to our shareholders." – Muhammad Yunus

Grameen Bank does not pursue profits for themselves. Yunus found his path to run a microfinance business through the clear goal he had defined – helping people overcome poverty. So Yunus designed Grameen Bank to be owned by its borrowers, and to be focused on women borrowers in particular not necessarily because it was a good business but because he believed the impact on the family was greater when women had access to credit. Also Grameen Bank issued loans that helped children go to school not because it brought money to them but because they thought it was a meaningful investment. Grameen Bank did not want to become another loan shark for the poor and believe they have created credit to the poor in a much more powerful way than what they had before.

Yunus claims that Grameen Bank’s shareholders should be the poor people and the profits made from the bank should be given back to the poor-shareholders for them to further expedite development. In order to do so he believes that MFIs should adapt a legal deposit-taking framework to raise local funding rather than returning investments to the international capital market, “because the poor should also have the privilege of taking a sip out of the ocean of money.”

Grameen Bank believes there is a tradeoff between serving the poor and making a good profit. Yunus says with an objective to make money, the company will move away from social mission naturally. He says “You cannot have both a social and a commercial mission – the two
conflict. *When institutions with a social mission move towards a commercial mission, the commercial mission will take over and the social mission will get lost.*”

### 2.2 Interest Rates on Loans

Interest rates on loans charged by microfinance institutions are high compared to other traditional banks. The interest rates Compartamos Banco charged at the time of IPO in 2008 were around 85 percent per year plus 15 percent government tax. Around the same time and to now, Grameen Bank's interest (reducing balance basis) on its main credit product is about 20 percent.4

**Compartamos Banco**

Chu says “*Banco Compartamos Banco is one of the best things that could have happened to the poor in Mexico.*” Compartamos Banco believes that their successful IPO triggered other MFIs to enter into the microfinance business and lead to creating a microfinance industry in Mexico, allowing more access to microfinance for the poor. “*Part of the dream when we created it in 1998 was that this would one day happen: that people would rush in, having found that it is as rational to serve the poor, as it is to serve the wealthy.*”

Chu believes that competition will take effect in lowering interest rates, forcing more efficient cost structures, and lowering profit. He believes evidence is in the Bolivian MFIs that competition drove interest rates down from 75-80 percent in 1998 to the lowest now at 18 percent per year. Its ROEs have also been increasing as they have learned to reduce costs faster due to pressure from competitors. However, according to Richard Rosenberg, Senior Advisor to

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the Consultative Group to Assist the Poor, from 2003 to 2006, microcredit interest rates have been dropping quite fast at a rate of 2.5 percent a year. But it doesn’t tell whether it is coming from competition or the improved learning curve.

**Grameen Bank**

Yunus believes that charging the poor extreme interest rates is taking advantage of the poor and it is not the kind of help they want to provide. Yunus says, “*The idea that competition will somehow reduce interest rate is a pipe dream.*” He claims that it can only be lowered from the bottom up as many financial services too despite the increased competition still offer at varying interest rates. He believes the competition to make MFIs become rich is not useful but the competition in doing well to people is the useful competition.

**2.3 Funding the MFIs**

Two institutions have a different take on the funding method for their banks. Grameen Bank wishes to fund only from local sources – specifically through deposits to cover loans. Compartamos Banco is open to funding from global sources in the form of savings, debt, and equity - traditional funding method for commercial banks.

**Grameen Bank**

Yunus says the “*ultimate solution for microcredit is to rely on local money. You need to open the gates of local money, so that you are not dependent on external money.*”

He sees many problems in external money – such as foreign exchange risk, and believes administration and management of foreign capital can take away the focus from the real solution:
local money. Yunus says that until MFIs take a legal framework to take deposits, donor funds will be important to MFIs either in form of grants or loans. Also he says donations through more wholesale funds should be developed because direct relationships between MFIs and donors are very cumbersome. He believes that in an immature microcredit market, wholesale donor funds should be leveraged until MFIs can receive a necessary legal approval from the government to take deposits.

**Compartamos Banco**

Chu says that the poor should get access of money from savings of the world and not just locally. He says risk of foreign capital is different depending on whether it is an equity or debt. For raising equity capital, only the investors are exposed to the foreign exchange risks. For debt capital, it is up to the treasurers of MFIs to manage the balance on how much foreign currency denominated debt to carry versus how much of local currency debt to carry depending on the prevailing exchange rates and interest rates.

Chu believes that donors, foundations, charity and developmental agencies played a very important role in the evolution of microfinance and none of the institutions that exist today would have made it without the donor money – including Compartamos Banco in its early years. However, he argues that they should not compete in the market where commercial funds can already assist development. In order for the donation funds to be noticeably influential, “*They should focus on the role in which they are best: nurturing ideas, concepts and methodologies that are ahead of the market, in order to accelerate their application ... Donors must be careful that they do not delay the entry of market mechanisms.*”
2.4 Future of MFIs

Compartamos Banco

"I am afraid that politicians and regulators will fail to understand the need to create and maintain a legal framework that will accelerate the development of the market by promoting competition, transparency and solvency." – Michael Chu

In terms of regulations and governmental efforts for MFIs, he says particularly capping interest rates is counter-productive as he believes it will eventually lead to financial services no longer being provided. Interest rate ceilings can be placed when regulators believe that financial institutions are making excessive profits by exploiting the clients or when they determine a market failure in the industry. Ceilings could however lead to higher risk as it could hinder ability of banks to identify higher risk clients who will be attracted to the capped interest rates. This leads to increased probability of default. It could drive out exploitive moneylenders out of the lending market, but will create problems for the MFIs who genuinely need market information to identify higher risk clients.

In terms of the future MFI business models, Chu believes without a doubt it will be the commercial financial institutions that will dominantly provide microcredit. It may or may not necessarily be today’s leaders in the MFI business, or global financial institutions that have yet figured out how to apply their competencies in providing microcredit profitably, or even new institutions that we have not yet envisioned. However, he notes that the current MFIs have made a clear accomplishment on bringing the poor a serious attention as the clients to serve.
Grameen Bank

In terms of future legal framework, Yunus believes that MFIs should take deposits to continue to expand without outside help. Yunus believes that in terms of government capabilities, governments within 20 years of time will probably not be the ones to manage microcredit. He sees that microcredit institutions will be owned by the borrowers themselves and that microcredit programs will be created as social businesses. He believes that microfinance will not be an opportunity to do business on, but an opportunity to change the lives of the poor. He also sees that exciting technologies like mobile phones will play a big role in microcredits (World Microfinance Forum Geneva, 2008).
3. Comparative Analysis: Grameen Bank versus Compartamos Banco

3.1 Grameen Bank Model

"Grameen Bank's objective is to bring financial services to the poor, particularly women and the poorest— to help them fight poverty, stay profitable and financially sound. It is a composite objective, coming out of social and economic visions."\(^5\)

3.1.1 Women Empowerment

According to Yunus, women up to 2004 still represented less than 1 percent of commercial loan recipients (Yunus M., 2004). At Grameen Bank, 96 percent of its clients are women, and today it has about 8 million women clients which represent about 11 percent of women population in Bangladesh. Figure 1 shows the portion of women and men clients over time. Grameen Bank believes women’s access to capital would provide them with more share of power in their households and in turn in the society. Studies indicate that lending to women generates considerable secondary effects, including empowerment of a marginalized segment of society (Yunus & Jolis, 2003). Women were more likely to participate in voting, have fewer children, and influence household decisions after receiving the loan (Pitt, Khandker, & Cartwright, 2006).

The idea of providing banking to the poor was originated when Economics Professor Muhammad Yunus at Chittagong University, later the founder of Grameen Bank, first encountered a young woman named Sufia Khatun in Jobra Bangladesh. Sufia had the skills to weave beautiful baskets, so the private moneylenders had been lending her 25 cents at 10% daily interest under a binding contract that she would sell all her baskets at the price that moneylenders asked for. Sufia, desperately in need to support herself, took the loan to buy materials for the basket but was never able to escape her ‘bonded labor’ cycle as she had to sell her baskets to the moneylender much below market price, leaving her only about 2 cents to support herself (McMillan & Hanley, 2003).

Professor Yunus, discomforted by the disconnection between the elegant economics

Figure 1. Grameen Bank Clients
Source: Grameen Bank Historical Data Series

3.1.2 History

Grameen Bank, Historical Data Series <http://www.grameen.com>
theories he was teaching and what was actually happening around his neighbors in poverty, decided to lend money to the debt-trapped villagers. He formed a list of villagers who were borrowing from the moneylenders and found 42 people with a total amount of US$ 27 in need. Without hesitation he took US$ 27 out of his pocket and lent to these 42 people, and to his surprise he received a full repayment from the borrowers. He kept lending more and more in a similar pattern and found the repayment to be perfectly made every time. He soon took his success stories to the banks to convince them to offer loans to the poor but was rejected as banks considered the poor “not credit worthy” (McMillan & Hanley, 2003). To prove and persuade to banks to provide credit to the poor, Professor Yunus eventually took on a Grameen Bank Project in 1976 in Tangail, a district just north of Dakata, the capital of Bangladesh. The project was a success and he continued to expand the project into more areas in the country. However, even after multiple proofs no banks were willing to carry on his lending method.

Determined to create the lending system for the poor, Professor Yunus took this method to the Central Bank of Bangladesh and in 1983, founded his independent bank. Grameen Bank, with Grameen meaning “village” in Bangla, was established in Dhaka with a right to distribute loans and to receive deposits.

Since then, as of 2011 year end, the cumulative disbursement of the loans are BDT 703 billion (US$ 11.6 billion) and the cumulative amount of savings deposited is BDT 66.55 billion (US$ 835 million). In 2011, Grameen Bank earned a profit of BDT 684 million (US$ 8.6 million) and declared 30% cash dividend.

7 Grameen Bank, Historical Data Series <http://www.grameen.com>
3.1.3 Group Lending and Qualifications

Women who are interested in receiving a loan need to find four other people who are also interested in receiving a loan to form a group of five members. Members of the group have to be comprised of people residing in the same neighborhood, same gender, and not members of the same family. Loans are given out to the individuals but the group as a whole is responsible for each other’s loans and any member’s default. Grameen Bank does not require any collateral to receive a loan, but in fact require candidates to have very few assets to qualify for the loan (McMillan & Hanley, 2003).

The candidate group goes through a training program offered by Grameen Bank few times a week for five to six weeks to learn about the loans, savings, interest rates, rules, and, Grameen Bank’s social slogan of Sixteen Decisions (Exhibit1). The illiterate candidates are taught to sign their names too. They are then quizzed by the area manager about things learned from the training program and once they pass, the area manager visits individual’s homes to make sure their assets are really very few, and their husband would support their wives’ transactions with the bank (McMillan & Hanley, 2003).

Qualified candidates receive the first loan, typically totaling around US$ 100. Fifty loan installments are paid weekly from the following week with evenly divided principals and interest payments. After a full repayment, the borrower is able to extend more credit for a new loan after her group and the center’s permission. Typically, loan amounts increase 10-30 percent a year, and with better credit the borrower could later qualify for a seasonal loan or a home loan (McMillan & Hanley, 2003).
3.1.4 Risk Management of Loans

Grameen Bank claims that the peer support and the peer pressure of the group members are the main drivers of keeping the default rates low. A member of a group would not only risk her own reputation but also risk her group members to be invited into another group for future loans when default occurs. The members also know each other well enough to understand the risk of default (Mainsah, Heuer, Karla, & Zhang, 2004).

Another layer of protection is made through the center manager of Grameen Bank. The center manager makes a weekly visit to the groups to monitor the loans, collect loan repayments or deposits, and discuss new loans that are brought to the center. The proposed loans are then further layered for protection again to the branch office to be reviewed by the branch manager (Mainsah, Heuer, Karla, & Zhang, 2004).

3.1.5 Loan Portfolio

![Figure 2. Grameen Bank's Loan Portfolio](http://www.grameen.com/)

Source: Grameen Bank Data & Report

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9 Grameen Bank, Data & Report <http://www.grameen.com/>
As of year-end in 2011, Grameen Bank’s loan portfolio is comprised of Basic (87 percent), Flexible (9 percent), Education (3 percent), Other (0.2 percent), and Housing (0.1 percent). The Basic loan is Grameen Bank’s core loan product which requires a weekly repayment over 3 months to 3 years duration. Basic loans usually show a 100 percent repayment rate. Flexible loan\(^{10}\) was introduced in 2000 to work for normal and disastrous situations, which is helpful when borrower finds it difficult to pay the weekly installments or needs to reschedule a loan. Education loans, introduced in 1997, lasts about 3-5 years with 0 percent interest rate during the study period, and 5 percent after the study period is over. Housing loan, introduced in 1984, is a 5 year loan with an interest rate at 8 percent and a credit line up to BDT 15,000 (US$ 188). Other loans include loans to struggling members (beggars) at 0 percent interest rate.\(^{11}\)

**Figure 2** shows how the loan categories have evolved since 1985. Before the big flood in 1998, there was no Flexible loan and the General loan was the equivalent of today’s Basic loan. General loans were granted up to US$ 125 to group members for income generating activities. Collective loans were given to organizations for building public road or community facilities but they had a poor repayment rate (Hassan & Renteria-Guerrero, 1997). Over its history, Grameen Bank’s loan portfolio has adapted and changed quickly to meet the needs of their clients at the bottom of the pyramid.

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\(^{10}\) Grameen Bank, Flexible Loan: On the last day of each month, 50 per cent provision is made against the outstanding amounts of flexible loans with age of less than two years, and 100 per cent provision is made against the outstanding amounts of flexible loans with age of two years and more. The portions of flexible loans, which complete the third year, are written off exactly on the date following their completion. http://www.GrameenBank.com/

\(^{11}\) Grameen Bank, Grameen Bank At a Glance, October 2011 <http://www.grameen-info.org/>
3.1.6 Operational Efficiency

The following formula shows the relationship that measures operational efficiency of a financial institution (Khandker, 1996). The interest rate charged on the loan should be at least equal to the cost of funding the loan principal, cost of processing the loan, and the cost of default combined in order to be break even as a bank.

\[ r \geq \frac{(i + \alpha + \rho)}{(1 - \rho)} \]

where

- \( r \) is the interest rate charged per unit of principal,
- \( i \) is the cost of borrowing per unit of principal,
- \( \alpha \) is the expected cost of administering and supervising a loan per unit of principal, and
- \( \rho \) is the expected default cost per unit of principal.
### GRAMEEN BANK

**Balance Sheet**

As at 31 December 2011

<table>
<thead>
<tr>
<th>Property and Assets</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash in hand</td>
<td>2,231,411</td>
<td>895,544</td>
</tr>
<tr>
<td>Balances with Bangladesh Bank—in local currency</td>
<td>1,036,511</td>
<td>2,574,932</td>
</tr>
<tr>
<td>Balances with other banks and financial institutions</td>
<td>1,706,290,207</td>
<td>1,308,117,165</td>
</tr>
<tr>
<td>Investments—at cost</td>
<td>52,612,942,436</td>
<td>47,757,186,897</td>
</tr>
<tr>
<td>Loans and advances—without collateral</td>
<td>77,639,276,539</td>
<td>68,417,977,923</td>
</tr>
<tr>
<td>Fixed assets (at cost less accumulated depreciation) (Annexure-A)</td>
<td>1,385,864,651</td>
<td>1,379,656,418</td>
</tr>
<tr>
<td>Investment property (at cost less accumulated depreciation) (Annexure-B)</td>
<td>104,236,476</td>
<td>108,540,014</td>
</tr>
<tr>
<td>Other assets</td>
<td>6,989,404,848</td>
<td>6,422,009,079</td>
</tr>
<tr>
<td><strong>Total Property and Assets</strong></td>
<td><strong>140,441,283,079</strong></td>
<td><strong>125,396,957,972</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital and Liabilities</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrowings from banks and other institutions</td>
<td>1,526,969,669</td>
<td>1,589,027,602</td>
</tr>
<tr>
<td>Members deposit</td>
<td>66,823,469,187</td>
<td>56,644,001,002</td>
</tr>
<tr>
<td>Non-Members deposit</td>
<td>50,692,905,197</td>
<td>48,378,999,640</td>
</tr>
<tr>
<td>Other funds</td>
<td>4,708,974,615</td>
<td>4,183,727,068</td>
</tr>
<tr>
<td>Deposits and other funds</td>
<td><strong>122,225,348,999</strong></td>
<td><strong>109,206,727,710</strong></td>
</tr>
<tr>
<td>Other liabilities</td>
<td><strong>8,816,718,694</strong></td>
<td><strong>7,238,222,597</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Shareholders’ Fund</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paid up capital</td>
<td>571,163,300</td>
<td>547,669,200</td>
</tr>
<tr>
<td>Capital and other reserves</td>
<td>7,056,892,417</td>
<td>6,685,290,863</td>
</tr>
<tr>
<td>Retained surplus</td>
<td>245,000,000</td>
<td>230,000,000</td>
</tr>
<tr>
<td><strong>Total Shareholders’ Fund</strong></td>
<td><strong>7,872,245,717</strong></td>
<td><strong>7,362,980,063</strong></td>
</tr>
<tr>
<td><strong>Total Capital and Liabilities</strong></td>
<td><strong>140,441,283,079</strong></td>
<td><strong>125,396,957,972</strong></td>
</tr>
</tbody>
</table>

**Table 1. Grameen Bank’s Balance Sheet 2011**

Source: Grameen Bank, Audit Report 2011

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GRAMEEN BANK
Profit and Loss Account
For the year ended 31 December 2011

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>OPERATING INCOME</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>INTEREST INCOME</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LESS: INTEREST/PROFIT PAID ON DEPOSITS &amp; BORROWINGS ETC.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net interest income</td>
<td>14,265,648,935</td>
<td>12,435,830,045</td>
</tr>
<tr>
<td>Income from investments in fixed deposits</td>
<td>-10,637,532,698</td>
<td>-9,227,772,950</td>
</tr>
<tr>
<td>Income from investments in Grameen Mutual Fund-One</td>
<td>3,628,116,237</td>
<td>3,208,057,095</td>
</tr>
<tr>
<td>Income from share investments</td>
<td>5,926,694,671</td>
<td>3,946,135,748</td>
</tr>
<tr>
<td>Other income</td>
<td>27,275,000</td>
<td>99,312,500</td>
</tr>
<tr>
<td><strong>Total Operating Income</strong></td>
<td>1,600,000</td>
<td>1,200,000</td>
</tr>
<tr>
<td><strong>LESS: OPERATING EXPENSES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and other related expenses</td>
<td>10,686,941,745</td>
<td>8,513,832,110</td>
</tr>
<tr>
<td>Rent, rates, taxes, vehicle insurance, utilities etc.</td>
<td>5,004,398,147</td>
<td>4,639,159,752</td>
</tr>
<tr>
<td>Legal and professional expenses</td>
<td>127,835,980</td>
<td>121,793,273</td>
</tr>
<tr>
<td>Auditors’ fees</td>
<td>237,726,222</td>
<td>233,111,678</td>
</tr>
<tr>
<td>Stationery, printing, advertisement etc.</td>
<td>1,405,525</td>
<td>1,377,800</td>
</tr>
<tr>
<td>Managing Director’s salary &amp; allowances</td>
<td>109,052,305</td>
<td>117,637,985</td>
</tr>
<tr>
<td>Directors’ remuneration</td>
<td>313,272</td>
<td>815,280</td>
</tr>
<tr>
<td>Repairs &amp; maintenance of fixed assets</td>
<td>174,000</td>
<td>42,000</td>
</tr>
<tr>
<td>Depreciation of fixed assets (Annexure-A)</td>
<td>41,781,689</td>
<td>47,007,495</td>
</tr>
<tr>
<td>Depreciation of investment property (Annexure-B)</td>
<td>67,587,695</td>
<td>70,798,924</td>
</tr>
<tr>
<td>Other expenses</td>
<td>2,371,872</td>
<td>2,405,278</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td>1,532,484,981</td>
<td>1,569,968,329</td>
</tr>
<tr>
<td><strong>Profit before provision</strong></td>
<td>7,125,131,688</td>
<td>6,804,117,794</td>
</tr>
<tr>
<td>Provisions for loans and advances</td>
<td>3,561,810,057</td>
<td>1,709,714,316</td>
</tr>
<tr>
<td>Specific provision</td>
<td>2,812,556,891</td>
<td>1,008,783,786</td>
</tr>
<tr>
<td>General provision</td>
<td>65,689,364</td>
<td>-56,310,792</td>
</tr>
<tr>
<td><strong>NET PROFIT</strong></td>
<td>2,878,246,255</td>
<td>952,472,994</td>
</tr>
<tr>
<td><strong>APPROPRIATIONS</strong></td>
<td>683,563,802</td>
<td>757,241,322</td>
</tr>
<tr>
<td><strong>NET PROFIT TRANSFERRED TO</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retained surplus brought forward from previous year</td>
<td>230,000,000</td>
<td>162,000,000</td>
</tr>
<tr>
<td>Dividend equalization fund</td>
<td>200,000,000</td>
<td>250,000,000</td>
</tr>
<tr>
<td>Cash dividend @ 30%</td>
<td>171,348,990</td>
<td>164,306,760</td>
</tr>
<tr>
<td>General reserve</td>
<td>280,000,000</td>
<td>260,000,000</td>
</tr>
<tr>
<td>Employees’ welfare fund</td>
<td>17,214,812</td>
<td>14,934,562</td>
</tr>
<tr>
<td><strong>Retained surplus</strong></td>
<td>688,563,802</td>
<td>689,241,322</td>
</tr>
<tr>
<td></td>
<td>245,000,000</td>
<td>230,000,000</td>
</tr>
</tbody>
</table>

Table 2. Grameen Bank's Income Statement 2011
Source: Grameen Bank, Audit Report 2011
Interest Income

For any banking institutions, managing the interest rate gap between its interest rate sensitive assets and liabilities is the key to profit maximization. Especially for a bank whose core product is a loan, it is critical that the bank generates sufficient interest income from the loan to sustain its operations.

In 2011, net interest income was positive at BDT 3.6 billion (US$ 46 million) with interest income of BDT 14 billion (US$ 179 million) and interest expense of BDT 10.6 billion (US$ 134 million) (P/L 2011). Grameen Bank’s main interest sensitive assets are microloans and fixed deposit investments. Interest sensitive liabilities include deposits and interbank borrowings.

Deposits

Grameen Bank’s goal is to fund all their microloans through deposits from the loan clients – the poor. As of 2011, consumer deposits are BDT 112 billion (US$ 1.4 billion) with member’s deposits of BDT 67 billion (US$ 839 million) and non-member deposits of BDT 51 billion (US$ 636 million) (Table 1). Loan principals balances are BDT 78 billion (US$ 975 million) (Table 2).\(^{13}\) Grameen Bank has generated 86 percent of the loan funding from member deposits and generated exceeding member and nonmember deposits (151 percent) to fully cover its loans just with deposits. With interest rates on deposits ranging from 8.5 to 12 percent per year, in 2011, interest paid on total deposits was BDT 10.6 billion (US$ 133 million) and interest made on loans was BDT 14 billion (US$ 178 million), leading to a positive interest gap on deposits to loans. Overall, although Grameen Bank is yet to reach its goal of funding 100 percent

\(^{13}\) Grameen Bank, Audit Report 2011 Notes to the Financial Statements <http://www.grameen-info.org/>
of its microloans through deposits from the loan members, but it sufficiently covers its loans only with deposit funding.

**Interbank Funding**

In 2011, Grameen Bank’s short term deposits placed at other banks and financial institutions was BDT 1.7 billion (US$ 21 million). Other fixed deposits which were classified as investments were BDT 52 billion (US$ 657 million). In other words, Grameen Bank’s interbank lending takes up 37 percent (BDT 54 billion) of its assets, ranking it the second largest income generating assets after microloans (55 percent). However, their income on a total interbank lending of BDT 54 billion (US$ 678 million) only generates BDT 6 billion (US$ 75 million) - 11 percent of principal when BDT 77.6 billion (US$ 974 million) microloan is generating BDT 14 billion (US$ 179 million) -18.37 percent of principal. Money market rates are very low due to globally low interest rate environment but the excess deposits generated from consumers are being placed to other banks at returns of 11 percent which is too low when deposit returns are around 10 percent. In terms of interbank lending, Grameen Bank is basically lending to other banking institutions mainly with their deposits from consumers at a very low return.

Grameen Bank’s interbank borrowing is BDT 1.5 billion (US$ 19 million), all of them being foreign aids which were received in the early days of Grameen Bank. The interest paid on foreign aid loans are around 2 percent and BDT 31 million (US$ 389 thousand). This is a very cheap funding source although it takes up only small portion of the funding. Grameen Bank has also received grants and concessionary loans from international aid agencies and foundations such as IFAD (International Fund for Agricultural Development), NORAD (Royal Norwegian Development Cooperation), SIDA (Swedish International Development Agency), ODA (British
Overseas Development Agency) and the Ford Foundation in the past. However, since 1995, Grameen Bank has stopped receiving additional foreign loans or grants.

**Shareholder’s Equity**

Shareholder’s equity was BDT 7.8 billion (US$ 99 million) in 2011. When Grameen Bank was established in 1983, government held 60 percent of the ownership of the bank by investing shares worth of BDT 12 million (US$ 0.50 million; 1983 – using average exchange rate of 1983), and BDT 6 million (US$ 0.24 million; 1983) through Sonali Bank and Bangladesh Krishi (Agricultural) Bank totaling in BDT 18 million of investments (US$ 0.74 million; 1983).\(^{14}\) However, Professor Yunus insisting that Grameen Bank should be owned by the poor assured that the government transfer the ownership to the borrowers once operation has been stabilized, and finally in 1986, 75 percent of government ownership was transferred to the borrowers.\(^ {15}\)

Since then, government has not added any more investments and still holds the remaining 25 percent of the original 60 percent holdings. However, because borrowers continued to expand their shares, the current ownership held by the government today came down to 3 percent.\(^ {16}\) As of 2011, Government of Bangladesh held 2.10 percent (120,000 shares), Sonali Bank at 0.53 percent (30,000 shares) and Bangladesh Krishi Bank at 0.53 percent (30,000 shares).

Out of the current 8.4 million borrowers in Grameen Bank, number of people who have bought the shares are 5.5 million. So about 63 percent of the borrowers own shares at Grameen Bank. Collectively, Grameen Bank’s goal is to fill the 97 percent of paid-up capital through the poor borrowers. Because government placed a ceiling on paid-up capital, Grameen Bank can

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15 Ibid
16 Ibid
only offer up to one share per borrower. The price of each share is BDT 100 (US$ 1.71; 2003). Currently females contribute 93.7 percent (5,351,749 shares) and males contribute 3.15 percent (179,884 shares) of the paid-up capital.\textsuperscript{17}

3.1.7 Growth

Grameen Bank has provided a cumulative of BDT 803 billion loans since establishment. Grameen Bank’s model of reducing poverty is by converting their microcredit borrowers into depositors and shareholders. So far they have taken the step of wealth redistribution by taking deposits from the wealthier regions and converting them into a loan to the poor people. Grameen Bank is proud of executing the reverse model of what traditional banks have been doing, which was taking deposits from the poor to transfer to the loan for urban educated elite (Mainsah, Heuer, Karla, & Zhang, 2004). Grameen Bank believes that they have distinguished themselves from such institutions by providing a sustainable solution to poverty reduction. Grameen Bank has remained without profit until in the early 2000s. According to the financial report of Grameen Bank, the ROE is 5.64\%, 10.74\%, and 8.97\% in recent 2009, 2010, and 2011 respectively. As a bank Grameen generates relatively lower ROE than other traditional commercial banks and other commercial microfinance institutions. ROE is not so relevant in assessing Grameen Bank’s performance because they do not seek to maximize interest rate on microloans but rather seek social benefits. However, they could still perform better and increase wealth for their poor shareholders by managing the interbank lending more efficiently. They

\textsuperscript{17} Borrowers are permitted to buy a share worth BDT 100 when his/her savings go beyond BDT 100. Grameen Bank explains that in the borrower’s pass book this transaction is recorded as a deposit of BDT 100 (US$ 1.71; 2003) under the share account. After this, the borrower’s name is listed on the share holders’ registry. The voter list for the election for membership in the board of directors is prepared on the basis of the share holders’ registry.
should decrease interbank lending and use those funds in increasing their microloans, therefore aligning their shareholders and borrowers with a common interest of alleviating poverty.

3.1.8 Macroeconomic Environment

Bangladesh is a South Asian Country near India and Burma. Bangladesh has a complicated history and politics. It became independent in 1972. Since its independence, the political situation has not been so stable. However, in the recent ten years, its economy developed quickly. In 2010, average GDP per capita was US$ 641, much lower than the average level of the world at US$ 8,985. According to the purchasing power, it ranked as 44th in the world. According to the World Bank, Bangladesh has a population of 150.5 million people, which is the world’s No 8 most populous country and one of the world’s No11 in terms of its density.18

3.1.9 Social Impact

<table>
<thead>
<tr>
<th>Poverty headcount ratio at national poverty line (% of population)</th>
<th>Year</th>
<th>Number of Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>31.50%</td>
<td>2010</td>
<td>8,340,623</td>
</tr>
<tr>
<td>40.00%</td>
<td>2005</td>
<td>5,579,399</td>
</tr>
<tr>
<td>48.90%</td>
<td>2000</td>
<td>2,378,356</td>
</tr>
<tr>
<td>50.10%</td>
<td>1996</td>
<td>2,059,510</td>
</tr>
<tr>
<td>56.60%</td>
<td>1992</td>
<td>1,424,395</td>
</tr>
</tbody>
</table>

Table 3. Poverty Ratios
Source: The World Bank19 & Grameen Bank Historical Data

According to the World Bank’s percentage of population in poverty, in 2010, 31.5 percent (47,407,500) were under the national poverty line. In 2010, Grameen Bank had 8.3 million active loan members, providing microloans to about 18 percent of people in poverty

19 Ibid
(Table 3). Assuming average of 4 people are in a family, this loan directly and indirectly affects about 70 percent of people in poverty. Microcredit is weaved into producing many other social impacts. According to Md. Khaled Shukran and Farhana Rahman, “There is a shift from wage employment in agriculture ... domestic service and household work in favor of trading, livestock rearing and domestic processing and manufacturing. The dependence on wage labor was much less among the Grameen Bank clients, as more of them turn to be an entrepreneur” (Shukran & Rahman, 2011).
3.2 Compartamos Banco Model

"We agree with the Pocantico Declaration that microfinance is distinguished by its primary purpose of maximizing long term value to low income clients in a sustainable manner. This can be achieved by the growing diversity of providers and approaches. But even within these diverse approaches, microfinance has to be treated as finance, because it is no different from it." - Carlos Danel & Carlos Labarthe, Co-Founders of Banco Compartamos, S.A

3.2.1 Evolution

_Founded as a Nonprofit Organization_

Compartamos Banco in its inception in 1991 was called Asociación Programa Compartamos Banco IAP (herein Compartamos-NGO). Compartamos Banco was founded originally as a non-governmental organization by José Ignacio Ávalos in 1990 with a mission of alleviating poverty in the bottom of the economic pyramid. Compartamos Banco’s initial model started out as a pilot project to provide small loans to poor women, creating opportunities for the credit constrained poor to fund their income generating activities.

Founder José Ignacio Ávalos dedicated himself to start a philanthropic organization when he was inspired by Mother Theresa’s commitment to the poor when she visited Mexico in 1982. With his commitment, José Ignacio Ávalos founded NGO Gente Nueva in 1984 with a mission to promote social change among young generation and to contribute to the economic development of Mexico. It was not until 1990 that they started microloans, which has today become their main business. They launched microloan originally as a pilot project to women in

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20 Compartamos Banco, A letter to our peers <http://www.compartamos.com/>
21 Compartamos Banco, Our History <http://www.compartamos.com/>
Chiapas and Oaxaca, the two poorest states of Mexico, and a year later in 1991, formally established themselves as Compartamos-NGO (Dugan & Goodwin-Groen, 2005).

**Nonprofit to Banking Institution**

In 1997, six years since establishment, Compartamos-NGO finally became financially self-sufficient. In October 2000, Compartamos-NGO first received its license for lending, and in 2001, signed ‘Acta Consitutiva de la SFOL’, an act to become a limited purpose finance corporation named as Financiera Compartamos Banco, S.A.. In 2006, the official name was converted to the now Compartamos Banco. Becoming a fully licensed banking institution enabled them to access commercial funding sources, which helped in reaching scale to serve more people. And by year end of 2006 it grew to be the largest MFI in Mexico, expanding out in 187 branches with 616,528 active clients and a loan portfolio of US$ 274 million with return on equity (ROE) was 56.1% and default ratio was 0.6% (Chu & Cuellar, Banco Compartamos Banco: Life after the IPO, 2008).

**Nonprofit to Banking Institution to Publicly Listed Company**

After growing from an NGO to the largest banking institution in Mexico in 2006, on April 19, 2007, Compartamos Banco decided to become a publicly traded company through an initial public offering (IPO) on Mexican Stock Exchange. It was a pioneering IPO as an MFI because it was the first MFI in Latin America and only a handful globally, to go public. It soon became the biggest talk in the industry as it raised a lot of path breaking as well as conflicting issues to different stakeholders and the MFI industry.
3.2.2 Fundraising

Fundraising Donations

In 1997, Compartamos-NGO finally managed to break even after six years since founding. Because they were an NGO, they were able to benefit through donations. Donation funding was one of their main drivers and an appropriate funding source at each stage of their growth.

<table>
<thead>
<tr>
<th>Year</th>
<th>Source</th>
<th>Amount</th>
<th>Type</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>USAID</td>
<td>50,000</td>
<td>Grant</td>
<td>start-up funding for pilot microfinance project</td>
</tr>
<tr>
<td>1993</td>
<td>IDB</td>
<td>150,000</td>
<td>Grant</td>
<td>restrictive usage</td>
</tr>
<tr>
<td>1993</td>
<td>IDB</td>
<td>500,000</td>
<td>Loan</td>
<td>restrictive usage</td>
</tr>
<tr>
<td>1995</td>
<td>Alfredo Harp Helu</td>
<td>1,000,000</td>
<td>Grant</td>
<td>unrestricted funding</td>
</tr>
<tr>
<td>1995</td>
<td>Banamex Social Development F</td>
<td>300,000</td>
<td>Grant</td>
<td>unrestricted funding</td>
</tr>
<tr>
<td>1996</td>
<td>CGAP</td>
<td>2,000,000</td>
<td>Grant</td>
<td>performance-based funding</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

Table 4. Grants and Soft Loans
Source: CGAP (Dugan & Goodwin-Groen, 2005)

At start-up in 1990, they received a US$ 50,000 grant from USAID, to fund staff training for the pilot microfinance project. In 1993, two years after it decided to be formally established as Compartamos-NGO, they received US$ 650,000 grant and loan from IDB. Although the funds came with specific instructions they had to follow, these were the funds that allowed them to expand. Ivan Mancillas, commercial director, Compartamos Banco recalled, "The IDB funding came at a moment when we were thinking as an NGO. We weren't thinking in a massive way, but in a local way. Sometimes it was difficult to follow their rules, but it helped us build a solid foundation" (Dugan & Goodwin-Groen, 2005).

Additionally in 1995, Compartamos-NGO received a personal donation of US$ 1 million from Alfredo Harp Helu, who was the advisor of Compartamos-NGO and a president of
Banamex, Citicorp's subsidiary in Mexico (Dugan & Goodwin-Groen, 2005). Through Banamex social development fund, they also received US$ 300,000 grant. Harp had had no restrictions on usage of funds. He was very helpful in bringing his banking experience to the organization by bringing in modified lending techniques, strengthened supervision, and raised effective interest rates to cover the cost of over 50% inflation and was helpful for growth during this stage. In 1995, Compartamos-NGO had been rejected from USAID for additional funding since their first microfinance project funds and was instead encouraged to attend the microfinance training course at the Economics Institute in Boulder Colorado. In 1996, Ivan Mancillas and Co-Chief Executive Officer Carlos LaBarthe attended the course, followed by with 90% of the management team, where they were able to gain deeper knowledge, meet leading experts in the field, and receive quality training to run an MFI.

After their training in 1996, Compartamos-NGO received US$ 2 million from CGAP under the condition that Compartamos-NGO met three criteria in three years: (1) an arrears rate below 10%, (2) 25% client growth annually, and (3) a specific annual target for ROA. According to CGAP, when CGAP began working with Compartamos-NGO, they did not even know the exact number of loans or the total funds in their portfolio but with smart and enthusiastic management did end up outperforming all their targets (Dugan & Goodwin-Groen, 2005).

Carlos Danel said, “we always had the goal to reach one million clients, but [at] the beginning, it was really a romantic goal. CGAP helped us make it a real target. This was the first time someone linked investing in us with our performance. CGAP proposed a grant contract linked to three targets and then they stood back and watched us perform” (Dugan & Goodwin-Groen, 2005).
These donation funds were the main drivers that enabled growth during the early stages of Compartamos-NGO and helped the company become self-sufficient by 1997. However, as they planned to grow more in scale, searching for donations as their main funding strategy was taking up a lot more time and resources, and it was limiting them to focus more on operations. Danel said, "We spent 80% of our time finding funds and only 20% doing what we had to do. Out of 10 doors that we knocked on, 9 remained shut. That was when we decided that we had to become a regulated entity --- so that we could access funds more readily and dedicate our time to executing Compartamos Banco' mission: creating opportunities by providing access to financial services for low-income families" (Chu & Cuellar, Banco Compartamos Banco: Life after the IPO, 2008).

**Fundraising in Financial Markets**

MFIs were not allowed to take savings deposits from consumers as they were neither categorized as a bank nor a credit union under Mexican banking regulations. Conventional banking institutions fund their growth through taking deposits, borrowing through inter-banks, or issuing bonds or equities. Since the earlier stages, Compartamos-NGO has been building their systems like other profitable businesses in the private financial sectors.

In 1998, Compartamos-NGO had slowly started transforming from an MFI to a limited-scope financial institution by finding a way to access funds from the financial market. In 1999, through investor/partner ACCION, Compartamos-NGO applied again to the USAID for an innovation grant. Through ACCION, the grant was allocated in three categories: US$ 800,000 through equity in Compartamos-NGO, US$ 1 million through subordinated debt, and US$ 200,000 through technical assistant grant. The US$ 200,000 grant initiated the very first launch
in urban Mexico City, when Compartamos-NGO had only experience in rural lending. After it received its license for lending in 2000, it stopped receiving donor funds and raised US$ 5 million through equity. As a licensed banking institution, Financiera Compartamos Banco, S.A., issued series of bonds starting out by 200 million MXN bond (US$ 20 million) in 2002. Guaranteed by their financial strength, the 3-yr 13.1 percent bond received an A+ rating from Standard and Poor. Compartamos Banco’s bonds were continuously issued to a total of US$ 70 million by 2007 as the market acknowledged their high profitability, low debt-to-equity ratio, and good corporate governance. They also had other forms of debts with commercial banks of up to US$ 130 million. “During the first 10 years of Compartamos we grew from 0 to 60,000 clients with US$ 4 million in grants.” Danel remarked. “In the next 5 years, Compartamos grew from 60,000 clients to 600,000 with over US$ 200 million in debt.” However, as Financiera Compartamos Banco, S.A. was growing, they found limitations on their license to be restricting their products for the clients. Especially when it came to the inability for offering savings accounts to the customers, it was not just restricting products but also eliminating a chance of obtaining funds at a low cost. In 2006, Financiera Compartamos Banco, S.A. became a fully licensed regular banking institution in Mexico called Banco Compartamos Banco, Institución de Banca Múltiple.

3.2.3 IPO

Compartamos Banco went public on April 19, 2007. Prior to IPO, shares were owned 39.2% by Compartamos Banco A.C., 18.1% by ACCION, 10.6% by IFC and 32.2% by individual shareholders. Some of the shareholders wanted to realize value on the largely grown stocks to invest in other products, and Compartamos Banco had to consider what would be the best options for the future of Compartamos going forward. At the crossroad of further expansion,
Compartamos Banco decided to raise more capital and become the first microfinance institution in history to go public. They held a secondary initial public offering and their shares were sold at Ps 40 and raising market capital of US$ 1.5 billion. Investors that sold 30 percent of their holdings had made US$ 450 million (Bloomberg Businessweek, 2007).

<table>
<thead>
<tr>
<th>At Dec 31</th>
<th>Pre-IPO</th>
<th>Post-IPO</th>
<th>2008</th>
<th>Mexico 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active Clients (thousands)</td>
<td>617</td>
<td>839</td>
<td>1,156</td>
<td>2,495</td>
</tr>
<tr>
<td>Loans - MM MxUS$</td>
<td>2,856</td>
<td>4,185</td>
<td>5,733</td>
<td>14,887</td>
</tr>
<tr>
<td>Net Income - MM MxUS$</td>
<td>632</td>
<td>877</td>
<td>1,120</td>
<td>2,051</td>
</tr>
<tr>
<td>ROE %</td>
<td>56.1</td>
<td>47.5</td>
<td>43.6</td>
<td>31.2</td>
</tr>
</tbody>
</table>

Table 5. After IPO and Global Financial Crisis
Source: Michael Chu, Harvard Business School (Chu, BBOP, 2013)

Within a year after IPO Compartamos Banco reached 1 million borrowers. After the IPO, Compartamos Banco credit lines increased and even had sufficient credit lines during the financial crisis. The successful IPO was proving to the financial market that providing financial services to the poor and generating profit can be balanced at the same time. Their IPO also triggered competition and brought more MFIs into the Mexican microfinance industry.

Critics of IPO were suggesting that the shareholder’s needs and poor people’s needs cannot be aligned as the investors expect high returns while the poor needs lower interest rate loans. Compartamos Banco believes that the main contribution of the microfinance should be the expansion of the market, and decided that they need the power of commercial principals to solve these problems. For the first 10 years as an NGO they were only able to serve 61,000 clients. But only five years after they became a commercial institution, they reached 600,000 clients, and with the IPO, to 1 million. Their strategy for expansion of microcredit was not just about their own growth. They needed higher than average profit, because they knew with the high profit, an industry could be built as other market participants will enter to join the momentum.
Compartamos Banco claims that they were committed to proving that microfinance as an investment worthy model in the financial sector. Back in 2005, when Deutche Bank said global demand for microfinance was US$ 250 billion and only 10 percent was reached, Compartamos Banco felt the need to raise more resources to scale. Before going public, they needed more funding choices as even with a AA credit rating, they were not able to place 100% of bonds in the local market.

As one of Compartamos Banco’s current competitors, Mauricio Hubard, from En Confianza Microfinanciera, has said: “Yunus opened the eyes of the world to microfinance. Compartamos Banco opened the eyes of the private sector and the financial markets. Thanks to the success of their IPO, we were successful in raising the initial capital we needed from private sector investors in less than a month. The success of Compartamos Banco, even if people want to make it controversial has changed the financial sector and opened new opportunities for companies with a social commitment.”
4. Conclusion

Chu says "If we look at the maybe 70 or 100 million people that are reached by microfinance today, that is not what is critically important. If we all lowered our interest rates for those 100 million, we would only benefit those 100 million. The key is: 'How do we reach with great urgency the several billion that are left?' Because every second of delay is a generation lost." He believes that being effective with these large number of people who could not reach their potential is the important issue (World Microfinance Forum Geneva, 2008).

Yunus says that the money spent on writing off trillions of dollars from conventional banks could be better used in microcredit that often has a repayment rate of 98 percent or higher. He believes that building an inclusive financial system where no one is rejected is important. Also he believes that another important issue is to build institutions that are self-reliant locally. "The more locally self-reliant microcredit institutions are, the stronger they will be. The more they are connected to something they do not know, the more uncertainty there will be." He hopes that people in the future could create poverty museums because poverty no longer exists (World Microfinance Forum Geneva, 2008).

Based on looking into the two different models of microfinance business, I have observed that they both commonly want significant social impact – specifically poverty reduction through microloans, achieve scale as more people in poverty needs to be reached, and achieve financial sustainability. The different philosophies between two institutions lead to two very different approaches; Grameen Bank taking a nonprofit approach whereas Compartamos Banco taking a commercial one. Although there are many different factors that surround the bank such as macroeconomic factors, regulations, competitive environment and etc. I find the key difference
between them lies in different funding methods. Grameen Bank aims to convert 100 percent of their microcredit borrowers into depositors, and they fund 100 percent of their loan with deposits. Compartamos Banco believes they need to be profitable to attract more investors who will fund their capital for expansion and therefore provide them with more resources to expand their services to the poor.

Two institutions show great business practices of microfinance institutions. I agree with both institutions that providing access of capital to as many people as possible is very important and financial sustainability of the institution is also very important in order to continue microfinance their business. However, I believe each business has more room to improve.

Grameen Bank should manage their assets and liabilities more efficiently by generating more microcredit loans to help the poor people rather than placing the excess deposits in the interbank money market. The bank should strengthen its treasury management as well as loan management as currently, the deposits raised at 8.5 - 12 percent are being inefficiently placed at around 11 percent interest return when it could be disbursed as microloans to reach more people in poverty and generate more income. More microloans to more people will also increase their ROE and in turn generate more income for the members who hold equity at the bank.

Although reaching the massive poor population is important, I am hesitant to agreeing to a single institution reaching scale or many institutions at once jumping into the same industry in the same region. I believe Compartamos Banco’s commercial model of raising capital from the investors, if properly managed, can help scale faster. Although reaching scale or triggering competition to increase accessibility to financial services is important as microcredit should be provided more to people in poverty, only reaching scale without a market wide system to support
could be risky. Without a market system that could not identify credit history or credit line of individuals, there is a higher chance of over-indebting the poor and it could eventually lead to another crisis similar to Andhra Pradesh. In that sense, with absence of proper industry-wide system, Grameen Bank’s small village level credit delivery system seems much more helpful as the social pressure among villagers replace the industry level risk management. Therefore, scaling the individual institution versus creating many small scale MFIs should be managed according to the regional situation.

Both models serve as a great role model in the microfinance industry. However, neither institutions have perfectly balanced social impact and financial returns as of today. Measuring these two differences is as comparing apples and oranges – they both have vitamin C but cannot measure what is better over another because they are genetically different. Until the correct balance between social impact and financial returns are figured out, we need to learn the best things out of each practices and further improve upon them.
Grameen Bank’s Sixteen Decisions

Grameen Bank’s 16 Decisions are an example of a social development program melded with microcredit delivery. They were developed in a 1984 workshop of Grameen Bank members representing 100 centers, and have been an integral part of Grameen Bank’s mission ever since.

1. We shall follow and advance the four principles of Grameen Bank:
   - Discipline
   - Unity,
   - Courage and
   - Hard work—in all walks of our lives

2. We shall bring prosperity to our families

3. We shall not live in dilapidated houses. We shall repair our houses and work towards constructing new houses at the earliest.

4. We shall grow vegetables all the year round. We shall eat plenty of them and sell the surplus.

5. During the plantation season, we shall plant as many seedlings as possible.

6. We shall plan to keep our families small. We shall minimize our expenditures. We shall look after our health.

7. We shall educate our children and ensure that we can earn to pay for their education.

8. We shall always keep our children and the environment clean.

9. We shall build and use pit-latrines.

10. We shall drink water from tubewells. If it is not available, we shall boil water or use alum.

11. We shall not take any dowry at our sons’ weddings; neither shall we give any dowry at our daughters’ wedding. We shall keep the center free from the curse of dowry. We shall not practice child marriage.

12. We shall not inflict any injustice on anyone; neither shall we allow anyone to do so.

13. We shall collectively undertake bigger investments for higher incomes.

14. We shall always be ready to help each other. If anyone is in difficulty, we shall all help him or her.

15. If we come to know of any breach of discipline in any center, we shall go there and help restore discipline.

16. We shall introduce physical exercise in all our Centers. We shall take part in all social activities collectively.

Source: Grameen Bank, 16 Decisions <http://www.grameen-info.org>
Works Cited


